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Supreme Court of the United States

OCTOBER TERM 1955

No. 921

W. FRANK LEE, JR., as Administrator of the Estates of W. FRANK LEE, deceased, and ANNE H. LEE, surviving wife, now deceased,

Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

RICHARD STEEL,
Counsel for Petitioner,
61 Broadway,
New York 6, N. Y.

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner, W. Frank Lee, Jr., as Administrator of the Estates of W. Frank Lee and Anne H. Lee, both deceased, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit in the above entitled matter.

Citations to Opinions Below

The opinion of Hon. Stephen E. Rice, a justice of the Tax Court of the United States, is printed in the Record (R. 360, 365).* It is unofficially reported in 12 TCM 861.

The prevailing and dissenting opinions of the Court of Appeals for the Fifth Circuit are printed in Appendix B hereto, (*infra*, pp. 22-32 inc.) and are reported in 227 Fed. 2nd 181.

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* All references unless otherwise indicated are to pages of the Transcript of Record upon which the appeal was argued in the Court of Appeals.

Jurisdiction

The judgment of the Court of Appeals was entered on November 25, 1955. By order of said Court Petitioner was granted permission to petition for re-hearing on or before January 25, 1956 (R. 415). Such petition was duly filed (R. 416-422). It was denied on the merits by order dated February 10, 1956, Circuit Judge Cameron dissenting (R. 423). Therefore this Petition is timely. *Bowman* v. *Loperena,* 311 U. S. 262, 266; *Pfister* v. *Northern Illinois Finance Corp.,* 317 U. S. 144, 149-150.

The jurisdiction of this Court is invoked under 28 U. S. Code, Sec. 1254(1) and Sec. 2101(c).

Questions Presented

1. May a tax predicated upon a net worth income reconstruction be assessed against a deceased reputable taxpayer after his death.

2. May fraud penalties be assessed by the Commissioner solely by indicating the possibility of a substantial deficiency created by the net worth method, without any affirmative evidence of fraudulent intent?

3. May the Commissioner sustain his burden of proving fraud under Section 1112 I.R.C. (1939) by merely defeating a deceased taxpayer's effort to show errors in the Respondent's computation, without supplementary evidence of fraudulent intent?

4. Were the assessments of any of the deficiencies for any of the taxable years barred by the Statute of Limitations Sec. 275 I.R.C. (1939)?

5. May fraud penalties be assessed against a deceased taxpayer?

6. May a delinquency penalty under Section 291 of the I.R.C. (1939) be assessed after the death of a taxpayer?

7. Were there any income tax deficiencies with respect to the returns filed by W. Frank Lee, deceased, for the taxable years ended February 28, 1942 to February 28, 1950 inclusive, and by W. Frank Lee and Anne H. Lee, surviving wife, both now deceased, for the taxable years ended February 28, 1949 and February 28, 1950?

Statutes Involved

The statutory provisions involved are Secs. 41, 275, 291, 293, and 1112 of the Internal Revenue Code of 1939 and Sec. 29.41-1 of Regulation 111, under the 1939 Code. They are printed in Appendix A (*infra*, pp. 20, 21).

Statement of the Case

These proceedings involve Federal income tax liabilities and fraud penalties against W. Frank Lee, deceased (hereinafter referred to as the Taxpayer) assessed after his death for the taxable years and in the amounts hereinafter indicated (R. 366).

Taxable Year Ended	Income Tax Deficiency	Sec. 293(b) Penalty	Sec. 291(a) Penalty
2/28/42	$ 728.16	$ 364.08	.....
2/28/43	3,371.70	1,685.85	.....
2/29/44	6,129.66	3,161.80	.....
2/28/45	13,215.22	6,741.98	.....
2/28/46	9,236.88	4,618.44	.....
2/28/47	4,600.30	2,300.15	$230.02
2/29/48	7,014.15	3,507.08	.....
	$44,296.07	$22,379.38	$230.02

together with a Federal income tax liability and one fraud penalty against the deceased Taxpayer and Anne H. Lee, surviving wife, for the taxable years ended February 28, 1949 and February 28, 1950 in the following amounts (R. 367):

Taxable Year Ended	Income Tax Deficiency	Sec. 293(b) Penalty
2/28/49	$3,898.76	$1,949.38
2/28/50	1,335.70	
	$5,234.46	$1,949.38

To such tax liabilities interest has been added as provided by statute for an average period of ten years or 60% of the deficiencies. The total tax, penalties and interest have been paid under protest by the Petitioner. The amount was ninety nine thousand seven hundred seventy-five and 73/100 dollars ($99,775.73).

It should be emphasized that respondent did not audit Mr. Lee's income tax returns nor make any deficiency assessments, until after the Taxpayer died on March 15, 1950, and his son W. Frank Lee, Jr. had been appointed Administrator of his estate by the Ordinary's Court of Wilkes County, Georgia on May 2, 1950 (R. 153).

For the fiscal years ended February 28, 1941 to February 28, 1948, W. Frank Lee, deceased, filed individual income tax returns with the Collector of Internal Revenue for the District of Georgia (Exs. A-G incl.) (R. 339-340). For the fiscal years ended February 28, 1949 and February 28, 1950, joint income tax returns were filed by or for the Taxpayer and his wife Anne H. Lee, in the same district (Exs. H and I) (R. 340). The facts are presented chronologically.

From 1906 until the date of his death, W. Frank Lee was the owner and operator of a dry goods store located off the Square on Main Street, in Washington, Georgia,

which store was known as the W. Frank Lee Department Store (Stip. Par. 32) (R. 348). From the time of the commencement of his business aforesaid, the Taxpayer had maintained single entry books of account without change in form or method (R. 241). It will be observed that the same antedated the first modern income tax laws by seven years (Amendment 16 United States Constitution). There was no certified public accountant in the community (R. 209). The business operations were conducted as follows: upon effecting a sale, an employee or the Taxpayer himself would prepare a sales slip, in duplicate (Pet. Ex. 5) (R. 242). The number of the employee would be placed thereupon. At the end of each day these sales slips would be tabulated and separated between the charge and cash transactions, and the totals entered in the cash book (R. 242-257). The sales slips representing charge accounts were kept for several years, the cash tickets were maintained for several months after they were recorded in the cash book at two separate places; under cash receipts and on the employees' bonus page (R. 249). Except for some petty disbursements substantially all of the Taxpayer's business expenses were paid by check, *i. e.*, the rent (R. 248) merchandise (R. 249, 254), etc. Wages were paid partly in cash and upon each of such instances "out tickets" were prepared for entry in the books (R. 248). At the end of the year each sales girl other than temporary employees received a bonus which was always paid by check. The Taxpayer carried merchandise of reputable and recognized manufacturers, with whom he maintained charge accounts. He made no purchases locally. At the end of each month bills would be received which were paid by check and entries made of such payments in the books. In substantially all instances, Taxpayer was required to sell his nationally advertised merchandise at fixed prices (R. 254).

It is of importance to observe that each year from the commencement of the business in 1906 the decedent took a

physical inventory of the merchandise on hand (R. 243, 259), and a detailed record thereof was made in the books (R. 244), (Pet. Ex. 6). By this method, the Taxpayer was able to reconcile his sales against his purchases and of course, balance his accounts. The integrity of the Taxpayer was not only testified to by the President of the local bank, produced as a witness by the Respondent (R. 143) but attested to by the incontrovertible fact that during the taxable years in question he reported in his income tax returns receipts of $47,475.53 in excess of his actual deposits in his bank account (R. 217, 315).

On or about August 1, 1950, subsequent to the Taxpayer's death, Mr. Roger M. Denning, an Internal Revenue Agent, was assigned to make a field audit for the taxable years ended February 28, 1949 and February 28, 1950 and possibly February 28, 1948. Concededly, the agent had never met the Taxpayer personally (R. 203).

As previously noted the Taxpayer had died on March 15, 1950. On or about December 17, 1951 the Administrator of the Taxpayer's estate filed a Federal Estate Tax Return together with a covering letter (Pet. Ex. M., Joint Ex. 9MM).

The return showed a gross taxable estate of $176,266.43, consisting of stocks and bonds in brokerage accounts, which had been acquired over many years prior to Taxpayer's death.

The examining agent, Mr. Denning, prepared a net worth computation of the Taxpayer's income commencing with the fiscal year ending February 28, 1942 (R. 214-216, 355). The opening net worth focal date was February 28, 1941.

To establish the valuation of the deceased Taxpayer's assets the Respondent relied almost entirely upon testimony of the agent who stated that he determined the net worth by an examination of the County Clerk's records

and other business reports. Of course, the deceased Taxpayer was unavailable for inquiry and his son Frank Jr., the Administrator, was but 20 years of age in 1941 and was then in the Armed Services. Respondent offered in evidence records of the United States District Court of Georgia, (Res. Ex. K), which indicated that on October 7, 1930, the Taxpayer had been adjudicated an involuntary bankrupt and that thereafter had made a composition with his creditors (R. 353). This was almost 11 years before the initial focal date and 21 years prior to the deficiency assessment (R. 24, 25, 65, 66).

Upon the trial counsel for the Petitioner strenuously objected to the admission in evidence of the certified copy of the bankruptcy proceedings on the grounds that the same was too remote. The objection was overruled and an exception duly noted (R. 99-101). To such ruling the Petitioner assigned error in the Court below (R. 380).

Mr. Denning made no effort to verify the sources of the funds sent by the Taxpayer to his brokerage accounts. Petitioner's accountant traced almost 90% thereof to reported income. As was indicated by Circuit Judge Cameron in his dissenting opinion, the opening net worth as of February 28, 1941, the original focal date, was never established by Respondent with any degree of certainty.

Although the annual inventory records appear in the books, the Examining Officer made no effort to analyze the same, nor did he attempt a reconciliation, although he admitted under cross examination such steps should have been taken (R. 222, 223). In utilizing the net worth method, the Treasury Agent completely ignored the books and voluminous records delivered to him for his consideration. With the Taxpayer dead and unable to answer questions, the agent obviously deemed it less burdensome to employ the net worth method, fully aware that the Administrator could hardly be expected to successfully refute such highly artificial procedure. Apparently this agent who

was being transferred to another division acted hastily and did not even complete the report which was ultimately prepared by a Mr. Herbert Young, his supervisor in the Department (R. 162, 176). Mr. Young was not called as a witness by the Respondent.

Joint income tax returns for the two last fiscal years of his life were filed for and in behalf of the Taxpayer and his wife Anne H. Lee. At the time of the trial Mrs. Lee was a lady upwards of seventy years of age, had never been active in the business of her deceased husband or in any of his financial transactions; she did not prepare or assist in the preparation of the joint income tax returns (Stip. Par. 33) (R. 348). Therefore Mrs. Lee could not aid the Administrator in his effort to refute the arbitrary deficiencies and fraud assessments. On November 2, 1955 Mrs. Anne H. Lee died in Washington, Georgia and on March 5, 1956 her son W. Frank Lee, the Petitioner, was duly appointed the Administrator of her Estate and is acting as such.

Judge Rice of the Tax Court not only held that the Petitioner had failed to sustain the burden of proving the deficiency assessment erroneous, but that the Respondent had sustained his burden of proving a fraudulent intent to evade taxes. The latter holding was predicated solely upon the artificially created income differential and without any affirmative evidence of fraudulent intent to evade payment of taxes.

Upon appeal the questions of law and fact here posed were submitted to the Court of Appeals Fifth Circuit for determination. Chief Judge Hutcheson writing for himself and Circuit Judge Borah, affirmed the original determination.

Circuit Judge Cameron filed a dissenting opinion.

It might be observed that with respect to the employment of the net worth method both the prevailing and

dissenting opinions indicated the practical impossibility of a deceased Taxpayer explaining any discrepancy in his income created by an arbitrary reconstruction thereof. Judge Hutcheson held however that such problem is but a question of a fact to be determined by the trial judge in the light of all the evidence. Judge Cameron held that it was the intention of this Court to give "cautious approval" to the net worth method on the assumption only that a living taxpayer with intimate knowledge of all the facts might destroy the purported income deficiencies artificially constructed by the Commissioner. It follows that such method has no place in the government's dealings with its respectable and law abiding citizens after they are dead and are unable to defend themselves and whose personal representatives are in no position to explain transactions which occurred many years before their taxpayer's death.

Reasons for Granting the Writ

The questions here presented have never been passed upon by this Court. It is respectfully urged that they should be.

I.

A net worth income reconstruction should not be used against a deceased taxpayer. Almost all authorities agree that a reconstruction of income by use of the net worth expenditure computation can be justified only in certain limited cases, otherwise it is an arbitrary and capricious method which violates the fundamental rights of a taxpayer. When properly applied the theory is that should a taxpayer's net worth over a fixed period be substantially increased, the burden is upon the taxpayer to prove that the initial net worth valuation as determined by the Commissioner was inaccurate and that the funds representing

purported increases in his net worth were derived from non-income sources. *Bryan* v. *United States,* 175 Fed. 2d, 223, 227 (C. A. 5, 1949); aff'd 338 U. S. 552; *Demetree* v. *United States,* 207 Fed. 2d 892 (C. A. 5, 1953); 2 Mertens: Law of Federal Income Taxation (1948) Secs. 12.12, 12.14; "The Net Worth Audit Problem * * *", 35 Iowa Law Review, pages 432, 434.

Only recently has this Court sustained Respondent's rights to utilize the net worth and expenditure method in reconstructing the income of a living taxpayer. *Holland et ux.* v. *United States,* 348 U. S. 121 (1954); *Friedberg* v. *United States,* 348 U. S. 142 (1954); *Smith* v. *United States,* 348 U. S. 147 (1954); *United States* v. *Calderon,* 348 U. S. 160 (1954). The pivotal decision of these four determinations is the opinion of Mr. Justice Clark in *Holland* v. *United States, supra,* in which he wrote at page 126:

> "One basic assumption in establishing guilt by this method is that most assets derive from a taxable source, and that when this is not true the taxpayer is in a position to explain the discrepancy."

To call upon a deceased taxpayer to explain a purported increase in his net worth resulting from an investigation instituted after his death is somewhat unrealistic and certainly improper and inequitable. This is particularly true of a reputable business man engaged in a legitimate enterprise and against whom not an iota of irregular activities can be proved. The Commissioner's use thereof herein was an arbitrary exercise of his power under Sec. 41 of the Internal Revenue Code of 1939.

Respondent might suggest as he did below that if the Taxpayer were alive and present during the investigation or at the hearing, it is just as logical to assume that he could offer no satisfactory explanation for his expenditures and investments. This negative form of reasoning

is hardly worthy of comment. An assumption as to what a living taxpayer might or might not have been able to do under a given set of circumstances, is pure speculation. It cannot be said that by reason of the death of the respectable and responsible Taxpayer herein that his Administrator during the audit or hearing could satisfactorily explain all of his intestate's financial transactions over a period of twenty (20) years prior to his intestate's death. The very weakness of the Respondent's position lies in an hypothesis that an Executor or Administrator can make suitable explanations, which assumption is totally without foundation and finds no evidence whatsoever in the record at bar to support it. Actually simple logic dictates that only the Taxpayer might reasonably be expected to offer detailed explanations of his expenditures and purchases. The net worth theory can find justification only if it can approximate a taxpayer's income. Two distinct factors are required: (1) ascertainment with reasonable accuracy of the increased net worth and unaccountable expenditures; and (2) taxpayer's opportunity to adequately explain the sources of the funds and the purported alleged increase in his net worth. See *Holland* v. *United States* (*supra*). Unless both factors exist, the use of the net worth method of reconstruction of a deceased taxpayer's income results in an arbitrary and capricious determination which the Courts below should have summarily rejected. Petitioner does not contend that there exists any statutory prohibition against the use of this method, but rather that the application thereof in the case of the deceased Taxpayer at bar could not possibly have complied with the provisions of Sec. 41 of the Internal Revenue Code of 1939 or Regulations 111. The statute and regulation makes it mandatory that the Commissioner employ a method which will "clearly reflect the income." The use of the net worth method herein by the Commissioner against the Estate of W. Frank Lee, the deceased Taxpayer, who was never afforded an opportunity to verify the valuation of his

assets as of the initial focal date nor was he available to explain the source of the funds employed by him to make subsequent investments violates every principle of equity and the statutory requirement clearly expressed in the phraseology thereof.

In *Holland* v. *United States* (*supra*), Mr. Justice Clark wrote:

> "Although it may sound fair to say that the taxpayer can explain the 'bulge' in his net worth, he may be entirely honest and yet unable to recount his financial history." (p. 128)

If such were written by this Court concerning a living taxpayer, the dicta is of greater persuasion against a deceased one. *Garrie Estate* v. *Commissioner*, 25 B. T. A. 757 (1932).

It is respectfully suggested that Circuit Judge Hutcheson in his majority opinion misinterpreted or did not follow this Court's directives set forth in the *Holland* case. He ignored the caution which Judge Clark emphasized. This Court stated that the method might be employed with respect to a living taxpayer under the conditions above specified and only cautiously in order to avoid the ensnarement of an honest taxpayer in a maze of inferences.

This Court neither ruled nor implied that the net-worth expenditure method of reconstruction of income could be used against a deceased reputable Taxpayer.

II

Fraud may not be established unless substantial evidence of fraudulent intent to avoid the tax is presented by the Commissioner. Petitioner here seeks a determination of the proper administration of the tax fraud statute,*

The statute dictates that, upon the issue of fraud, the Commissioner had the burden of proof. The evidence

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* Sec. 1112, Internal Revenue Code of 1939.

thereof must be clear and convincing. *Lalone* v. *United States,* 164 U. S. 255, 257 (1896); *Kerbaugh* v. *Commissioner,* 29 B. T. A. 1014, 1016, aff'd 74 Fed. 2d 749 (C. A. 1st, 1935).

In the case at bar, a paradox has been created. The burden of proving the error in the Commissioner's computations was upon the Petitioner. On the other hand the burden of proving fraud was upon the Respondent. The finding below implies that the failure of the Petitioner to meet his burden required a finding that the deceased Taxpayer had fraudulently and intentionally grossly understated his income. Thereupon fraud was impugned to the decedent by such finding without the necessity of supplementary evidence of wrongful intent. It follows that the burden imposed upon Respondent by statutory mandate to prove fraud became a nullity. In *Vitelli & Son* v. *United States,* 250 U. S. 355, 359, Mr. Chief Justice White wrote of a somewhat similar situation involving custom duties:

> "The inevitable result of the argument is to cast upon the citizen the perpetual burden of showing he had not been guilty of wrong * * *."

The Courts below have held Petitioner's inability to disprove the accuracy of the Commissioner's computations automatically warranted a finding of fraud against this reputable deceased Taxpayer.

In *Davis et ux.* v. *Commissioner,* 184 Fed. 2d 86 (C. A. 10th 1950), the evidence indicated that the taxpayer had understated his income by approximately one thousand per cent. The Respondent there argued that such gross understatement of income, implied an intent to defraud. The Court wrote at page 87:

> "Fraud implies bad faith, intentional wrongdoing and sinister motive. It is never imputed or presumed and the Court should not sustain findings of fraud

upon circumstances which at the most create only suspicion."

See also *Griffiths* v. *Commissioner*, 50 Fed. 2d 782 (C. A. 7th, 1931).

Attention is respectfully directed to *Wisely* v. *Commissioner*, 185 Fed. 2d, 263 (C. A. 6th 1950) in which the Court was called upon to determine whether or not a physician, who had failed to report large amounts of his income, and whose records were loosely maintained, was subject to fraud penalties. In dismissing the fraud charges, the Court stated, in substance, that such evidence was insufficient, because "fraud cannot be lightly inferred, but must be established by clear and convincing proof." See also *Godwin* v. *Commissioner*, 34 B. T. A. 485, 493, 494 (1936).

Judge Sibley, in *Mitchell* v. *Commissioner*, 118 Fed. 2d 308, 310 (C. A. 5th 1941), wrote:

> "The fraud meant is actual, intentional wrongdoing, and the intent required is the specific purpose to evade the tax believed to be owing."

Each case cited by the respondent below in support of his contention referred to a taxpayer who had been guilty of criminal, unethical or irregular conduct from which the Court could infer a general intent of bad faith or intentional wrongdoing. At bar the evidence is barren of any proof to support such contention. It is respectfully suggested that this Court should review the nature of the burden of proof imposed upon the Commissioner by statute and whether he may depend to sustain his burden solely upon the failure of a taxpayer, living or dead, to sustain his burden of disproving the accuracy of an arbitrary computation.

In re Locust Building Co. Inc., 299 Fed. 756, 765 (C. A. 2nd 1924) the Court wrote:

> "The general rule is that fraud must be made out by a preponderance of the evidence, which should

be so clear and strong as to preponderate over the general and reasonable presumption that men are honest and do not ordinarily commit fraud or act in bad faith. 27 C. J. 62, and in Wigmore on Evidence, vol. 4., sec. 2498, alluding to the rule that in civil cases a preponderance of evidence is sufficient, he states that a stricter standard is applied in cases of fraud. He says:

> 'But a stricter standard, in some such phrase as 'clear and convincing proof' is commonly applied to measure the necessary persuasion for a charge of fraud, and in a few related classes of cases'."

See also *A. W. Minyard* v. *Commissioner,* 6 T. C. M. 1137 (1947); 9 Mertens, Law of Federal Income Taxation (1948), Sec. 50.67.

In *Jemison* v. *Commissioner,* 45 Fed. 2d, 4 (C. A. 5th, 1930), Mr. Justice Foster wrote at page 5,

> "Fraud is not to be presumed, but must be determined from clear and convincing evidence, considering all the facts and circumstances of the case.

Referring to an attempt to establish fraud against a deceased taxpayer Judge Kern of the Tax Court wrote in *Snowden Estate* v. *Commissioner,* 6 T. C. M., 945, Dkt. No. 7237 (August 15, 1947), at page 959,

> "The next, and the principal issue herein, is whether the income tax return of petitioner's decedent for the taxable year 1921 was a false and fraudulent return filed with intent to avoid tax. The burden of proof as to this question is upon respondent, and the proof offered must be clear and convincing.
>
> "This burden of proof, is at best, a difficult one to meet since the ultimate fact to be proved is the intent or mental attitude of an individual. In the

instant case it is particularly difficult, and properly so."

As pointed out in the opinions below unless fraud were established by the Commissioner, deficiencies for the taxable years ended February 28, 1942 through February 28, 1947 would be barred under Section 275 Internal Revenue Code 1939. Apparently the fraud penalties were assessed by the Commissioner to escape the effect of the Statute of Limitations.

III.

Fraud penalties may not be assessed against a deceased taxpayer.

As early as 1664 the Courts of England held that an action for exemplary damages in connection with the failure to report taxes did not survive the death of a taxpayer. *Weeks* v. *Trussel,* 1 Eagle & Young 440. It was there stated that the same constituted a personal tort of the testator for which, by the common-law of England, the Executor could not be compelled to respond.

In *Schreiber* v. *Sharpless,* 110 U. S. 76 (1883), this Court held that an action to recover penalties and forfeitures under Section 4965 of the Revised Statutes for infringement of a copyright which the Plaintiff sought to prosecute against the executors abated with defendant's death. See also *Van Choate* v. *General Electric Company,* 245, Fed. 120 (D. C. Mass. 1917). In *Wickham* v. *Commissioner,* 65 Fed. 2d, 527, 531 (C. A. 8, 1933), members of a partnership were found to have filed fraudulent tax returns. Although 50% fraud penalties were claimed against one partner, the Respondent with the approval of the Court, dropped the fraud penalties against the estate of the partner who had died before the assessment was made. The Courts have held that penalties imposed by the Price Administrator under Section 205 (2) of the

Emergency Price Control Act, 50 U. S. C. Appendix 925(e), abated with the death of the defendant. See also *Popplewell* v. *Stevenson*, 185 Fed. 2d, 111 (C. A. 5, 1950). In *United States* v. *Theurer, etc.*, 213 Fed. 964 (C. A. 5 1914, cert. denied 235 U. S. 706) the Court held that a judgment entered in favor of the United States against the owner of whiskey seized as a violation of the Internal Revenue laws is for a penalty and abated upon his death.

In *Helvering* v. *Mitchell*, 303 U. S. 391 (1938) Mr. Justice Brandeis writing for the majority of this Court pointed out that Congress might impose both criminal and civil sanctions in respect to the same act or omission and that the civil penalties respecting a fraudulent return as provided by the Internal Revenue Code then in effect are not criminal sanctions, so that the double jeopardy provisions of the Constitution do not bar their assessment. He stated at page 401:

> "They are provided primarily as a safeguard for the protection of the Revenue and to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud".

See also *Spies* v. *United States*, 317 U. S. 492, 495 (1943).

Although this Court did not rule upon the abatement of tax fraud penalties the Commissioner of Internal Revenue and certain lower courts reversed the law effective since the foundation of our country and held that fraud penalties survive the death of a taxpayer. *Reimer Estate* v. *Commissioner*, 12 T. C. 913 (1949) aff'd 180 Fed. 2d 159 (C. A. 6th 1950); *Briden Estate* v. *Commissioner*, 11 T. C. 1095, aff'd *sub nom; Kirk* v. *Commissioner*, 179 Fed. 2d 619 (C. A. 1st, 1950).

In *Scadron's Estate* v. *Commissioner*, 212 Fed. 2d 188 (C. A. 2nd 1953), the Court felt constrained to follow the decisions of the 1st and 6th Circuits. However, in so doing the 2nd Circuit wrote:

> "We agree that, if we thought the question *res integra*, we might reach a different conclusion".

In *Helwig* v. *United States*, 188 U. S. 605 (1903), Judge Peckham wrote at page 611:

> "Whether the statute defines it in terms of punishment or penalty is not important, if the nature of the provision itself be of that character. If it be said that the provision operates as a warning to importers to be careful and to be honest, it is a warning which is efficacious only by reason of the resulting imposition of the 'further sum' in addition to the duties, provided by the statute".

In *Cotonificio Bustese S. A.* v. *Morgenthau*, 121 Fed. 2d 884, (Ct. App. D. C.) (1941), the question at issue was whether an additional duty of 10% imposed on an importer for failure to mark his merchandise to indicate its country of origin was a duty or penalty.

Following the *Helwig* case (*supra*), the Court ruled that the same constituted a penalty. At page 888 it wrote:

> "• • • A penalty like a rose, by any other name, smells just as sweet or sour. • • • The penal character of the exaction becomes the more obvious when it is imposed for intentional failure to comply with the Statute's requirements or for an attempt to defraud the Revenue or violate the law, but within the principle of the Helwig case, absence of such intention does not prevent the exactions having penal quality."

Congress has failed to enact any legislation which would require a reversal of the law of this country since its inception that penalties or sanctions abated with the death of the party charged.

Tax penalty provisions were contained in the earliest income tax statute (See Act Oct. 3, 1913 38 Stat. 114, 179) and have been re-enacted without substantial change in all succeeding Revenue Acts. Until 1940 it has been consis-

tently held that such penalties abated with the death of a taxpayer.

Whether tax penalties can be assessed against a deceased taxpayer is a question for legislative action not judicial interpretation. Assuming *arguendo*, that such penalties are remedial and not punitive then they may only be recovered if the actual damages are proved. *Sullivan* v. *Association of Bill Posters & Distributors*, 6 Fed. 2d, 1000, 1009 (C. A. 2nd 1925); *Bowles* v. *Farmers National Bank of Lebanon, Ky.*, 147 Fed. 2d, 425, 430 (C. A. 6, 1945).

IV

A delinquency penalty pursuant to Section 291 of the Internal Revenue Code of 1939 may not be assessed against a deceased taxpayer. At bar the Taxpayer's income tax return for the taxable year ended February 28, 1947 was not filed by him until approximately two weeks after its due date. The statutory penalty is obviously punitive and may not under any theory be construed as remedial. It therefore abated under the principles enunciated in III above.

V.

The questions involved herein are substantial and should receive the authoritative attention of this Court.

CONCLUSION

Petitioner respectfully prays that a Writ of Certiorari issue to review the decision below.

W. Frank Lee Jr., As Administrator of the Estates of W. Frank Lee and Anne H. Lee, both deceased.

By: Richard Steel,
Counsel for Petitioner,
61 Broadway,
New York 6, N. Y.

Dated: New York, N. Y., May 1, 1956.

APPENDIX A

Relevant Statutes

INTERNAL REVENUE CODE of 1939

Section 1112. Burden of proof in fraud cases.

In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Commissioner.

Section 41. General rule.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; * * *

Section 275. Period of limitation upon assessment and collection.

(a) General rule.

The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * *

(c) Omission from gross income.

If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

Appendix A.

Section 291. Failure to file return.

(a) In the case of any failure to make and file return required by this chapter, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to wilful neglect, there shall be added to the tax: 5 per centum if the failure is for not more than thirty days • • •

REGULATIONS III.

Accounting Periods and Methods of Accounting

Sec. 29.41-1. *Computation of Net Income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 29.42-1 to 29.42-3, inclusive). If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the commissioner clearly reflects it.

APPENDIX B

(November 25, 1955.)

Before HUTCHESON, Chief Judge, and BORAH and CAMERON, Circuit Judges.

HUTCHESON, Chief Judge: This appeal from unreported decisions and orders of the Tax Court involves deficiencies in income taxes and fraud penalties[1] determined by the commissioner to be due for the fiscal years ended February 28, 1942 to February 28, 1950, on account of income tax liabilities of W. Frank Lee, who died March 15, 1950. It also involves a penalty for the delinquent filing of taxpayer's return for the fiscal year 1947.

Because the deficiencies were not timely assessed and, but for proof of fraud all of such deficiencies except that for the last year in controversy would have been barred,[2]

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[1] "Sec. 293. Additions to the Tax in Case of Deficiency.

* * *

"(b) Fraud.—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in Sec. 3612(d)(2)". (26 U. S. C. 1952 ed., Sec. 293)

[2] "Sec. 275. Period of Limitation Upon Assessment and Collection.

"Except as provided in section 276—

(a) General Rule.—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period." (26 U. S. C. 1952 ed. Sec. 275)

"Sec. 276 Same—Exceptions.

"(a) False Return or No Return.—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time." (26 U. S. C. 1952 ed. Sec. 276)

the respondent had the burden[3] of proving by clear and convincing evidence that the decedent filed false and fraudulent returns.

The Tax Court in its decision expressly declared, "The respondent has the burden of proving by clear and convincing evidence that the decedent filed false and fraudulent returns for all but the last year in controversy", and as expressly found that the respondent had sustained that burden.

Petitioners are here insisting that the record will not support the determination and redetermination that there were deficiencies and if it will, it will certainly not support the finding that any part of them was due to decedent's fraud with intent to evade the tax. In addition to these attacks on the fact findings of the court, petitioners put forward two grounds of attack upon its conclusions of law. One of these is that the net worth theory of reconstruction of income, which was employed by the respondent in making his determination and in supporting his position below, could not properly be used in this case because the investigation was not commenced and the audit was not made until subsequent to the taxpayer's death, and that this deprived the taxpayer of the prime essential to a fair defense in a net worth theory case, the right and opportunity to explain the evidence put forward by the commissioner in support of it.

The other is that, since at common law tax penalties did not survive the death of a wrong doer, a fraud penalty may not be assessed against a deceased taxpayer.

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[3] "Sec. 1112 Burden of Proof in Fraud Cases.

"In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Commissioner." (26 U. S. C. 1952 ed. Sec. 1112)

Appendix B.

The commissioner, on his part insisting that the evidence is not only sufficient to support his contention that there were deficiencies and frauds in the years in question but that the proof almost compelled a finding that this was so, urges that upon the record nothing more than questions of fact are presented by this appeal, and that it cannot be said that the findings were clearly erroneous.

Of petitioner's legal positions that the fact of the death of taxpayer before the deficiencies were assessed prevents fraud penalties from being assessed against his estate or the net worth method from being used, the commissioner, citing in support *Holland, Friedburg & Smith* v. *U. S.,* 348 U. S. 121, 142, and 147, and *United States* v. *Calderon,* 348 U. S. 160, points out that, as there held, proof of tax delinquencies by the net worth method is merely to prove a case by circumstantial evidence. So pointing, he insists that the petitioners' contention, that the death of the taxpayer should operate as a bar to proof of a case by circumstantial evidence, is without support in reason or authority. No statute forbidding the use of such evidence is cited, and the consideration put forward by petitioners, that the taxpayer is deprived of an opportunity for explanation, while of course entitled to its due weight with the trier of the facts in determining the probative effect of the circumstantial evidence, can really have no proper bearing upon its admissibility.

As to the contention that fraud penalties are in the nature of penal assessments which may not be exacted of a decedent, the commissioner points to cases[4] which have considered the contention and held to the contrary, under the authority of *Helvering* v. *Mitchell,* 303 U. S. 391,

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[4] Scarron's Est. v. Commissioner, 212 F(2) 188; Est. of Reimer v. Commissioner, 12 T.C. 913, affirmed P.C. 180 F(2) 159; and Estate of Briden v. Commissioner, 11 T. C. 1095, affirmed in Kirk v. Commissioner, 179 F(2) 619.

that fraud penalties added under Sec. 293(b) are but civil administrative sanctions of a remedial character in aid of the assessment and collection of taxes, and that they are not to be considered or treated as penal sanctions which die with the offender.

We find ourselves in agreement with the commissioner in these contentions. Of the fraud issue, we think it need only be said that the Tax Court, in its unreported opinion, correctly placed the burden on the commissioner, and, marshaling the evidence and making findings in accordance therewith, correctly, we think, determined that that burden was carried. It is settled law[5] that where, as here, there is credible evidence supporting a charge that an understatement of income by taxpayer was due to fraud with intent to evade tax, whether the charge has or has not been proved is a question of fact for the Tax Court to determine, and its finding on this issue, just as on any other issue of fact, is final unless shown to be clearly erroneous.

It will, therefore, serve no useful purpose for us to set out the testimony on which the petitioners on their side and the Tax Court and Commissioner on theirs rely. Neither will it avail anything for us to enter into a discussion of the dangers inhering in the careless and indiscriminate use of the net worth method, nor the obligations imposed upon the commissioner to exercise care and restraint in its use. It is sufficient to say that this court has written many times on the subject of the dangers inherent in the use of the net worth method in criminal cases, and the Supreme Court in the Holland case, referring to cases written by us, has written in the same vein. In reviewing convictions in criminal cases by

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[5] Cf. Bryan v. Commissioner, 209 F(2) 822; Boyett v. Commissioner, 204 F(2) 205; O'Dwyer v. Commissioner, 110 F(2) 925.

the use of the net worth method where the proof of the guilt must be beyond a reasonable doubt, as well as in civil cases where preponderance will suffice, we have always kept this firmly in mind. However, we and the Supreme Court, as we are both bound to do, have recognized at all time that after all the question for decision in each case is whether the evidence, though circumstantial, constituted sufficient proof to sustain the challenged finding.

Considering the evidence in this case in the light of these principles, though we agree with appellant that the inability of the taxpayer to confute or explain what unconfuted and unexplained has damaging weight, has to that extent increased the factual difficulties of the taxpayer and lessened those of the commissioner, we are bound to hold that this consideration fully expends itself when giving it all the proper weight it is entitled to, we still cannot say, as we cannot here, that on the examination of the evidence as a whole we are left with the firm conviction that the findings were wrong and must be set aside. *Leech* v. *Sanders,* 158 F(2) 486; *United States* v. *Gypsum Co.,* 333 U. S. 364.

There remains for determination only the small penalty liability assessed for failure to timely file the 1947 return. While we agree with the taxpayers that there is no affirmative evidence that the delayed filing was deliberate, this will not avail them as a defense as this is not the language of the statute.* It, on the contrary, provides that the penalty is to be assessed unless reasonable cause

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* Sec. 291. "Failure to file return

"(a) In case of any failure to make and file return by this chapter, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the tax: * * * * *" Title 26 U.S.C.A. Sec. 291.

for not filing is shown, and it has been held repeatedly that whether there is reasonable cause for failure to file a timely return is a question of fact in respect to which the burden is on the petitioner and that its solution is peculiarly within the province of the Tax Court. *Plunkett* v. *Commissioner,* 118 F(2) 644; *Burford Oil Co.* v. *Commissioner,* 153 F(2) 745; *Commissioner* v. *Lane Wells,* 321 U. S. 219; *S. E. Finance Co.* v. *Commissioner,* 153 F(2) 205.

Nor is there any more merit in taxpayer's contention that the penalty for late filing cannot be imposed upon a deceased taxpayer. The appellant cites no cases so holding and in principle, if, as we have held, fraud penalties may be imposed, this particular penalty may be.

We find no basis for overturning the decisions and judgments of the Tax Court, and they are AFFIRMED.

CAMERON, Circuit Judge: I dissent.

CAMERON, Circuit Judge, Dissenting.

I.

I am unable to agree with the majority opinion because a review of the entire evidence in this case leaves me with the definite and firm conviction that a mistake has been committed. To begin with, the Tax Court made a mistake of law by admitting, over due objection, proof that the decedent had been adjudged a bankrupt ten years before the beginning point of the net worth computation. Although the Commissioner made no adequate explanation of decedent's finances during that ten year hiatus, the Tax Court evidently laid stress on the fact of the bankruptcy. It was entirely too remote for consideration.

Appendix B.

The decedent kept a set of books and the record contains no convincing proof of their inaccuracy. They were of the single-entry type, which the proof showed to be in common use in small businesses such as the decedent had operated. These books were entitled to consideration despite the fact that some features were in code,—also a common practice in that territory. Neither the Commissioner nor the Tax Court placed any reliance at all upon them.

The attempted proof of the initial net worth valuation of decedent's property was incomplete, and the government witness who made it so admitted. He was removed from that territory before he completed it, and assumed that his successor would complete it and furnish vital missing data. The Government did not introduce the successor as a witness nor bring in his report.

The accountant for petitioner also constructed net worth statements for the period involved, commencing at the latest date and checking backward. His figures varied quite materially from those developed by the Commissioner and were much more convincing. He demonstrated that the results achieved by the partial investigation of the government agent led to a virtual mathematical impossibility. Since the Tax Court's decision was based largely upon the work of this accountant, with respect to which we are in about as good a position to judge as was the Tax Court, it is our duty to weigh and analyze the figures adduced and, so doing, it is apparent to me that the finding of the Tax Court is clearly erroneous.

II.

As stated by the majority, most of the Taxes assessed were barred by limitation unless rescued by a showing of fraud. The showing by the Commissioner was, in my view,

entirely inadequate. The entire structure of proof was built upon the assumption that the net worth valuation placed by the government agent as of February 28, 1941 was correct. There was little competent proof tending to establish the correctness of this initial computation. It is manifest that the Tax Court presumed it to be correct on the ground that petitioner had not been able to meet the burden of disproving it; and, on that presumption alone and using those figures as a foundation, the Tax Court found that the decedent had grossly understated his taxes for the years in question. Based wholly upon that finding, the Tax Court found fraud. It is not permissible thus to establish a case "by piling one presumption or inference upon another presumption or inference", *Standard Accident Ins. Co.* v. *Nicholas,* 146 F. 2d 376, 5 Cir., 1944.

Even against the living, fraud cannot be inferred from the mere understatement of income as reflected by this record, but such proof must be buttressed by "direct evidence of conduct the likely effect of which would be to mislead or to conceal".[1]

This case reveals a cruelty which ought to be avoided if the ends of justice will permit. Decedent was a leading and respected citizen of a small town in Georgia for all of his life. Subsequent to his death the respondent began an investigation resulting in the assessment of these deficiencies and fraud penalties. Considerably more than half of the estate he left his widow is condemned to the tax

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[1] Holland v. United States, 348 U. S. 121, 125, quoting from Spies v. United States, 317 U. S. 492, 499. Although this and others cited were criminal cases, the underlying principles enunciated apply to all cases, and especially so where fraud is charged. In the Holland case, the court further stated (pp. 137-8): "Increases in net worth, standing alone, cannot be assumed to be attributable to currently taxable income." There was no proof here of any source of income except decedent's business.

gatherer by this decision. More than that, it filches decedent of his good name and "Takes that which not enriches him and makes me poor indeed". The words of Mr. Justice Storey in *Prevost* v. *Grotz*, 6 Wheat 481, 498, rise to condemn what is here done:

> "Fraud, or breach of trust, ought not lightly to be imputed to the living; for the legal presumption is the other way; and as to the dead, who are not here to answer for themselves, it would be the height of injustice and cruelty to disturb their ashes, and violate the sanctity of the grave, unless the evidence of fraud be clear, beyond a reasonable doubt."

III.

It is said that the net worth method of computing income taxes is nothing more than the use of circumstantial evidence. But, as pointed out by the majority opinion, both this Court and the Supreme Court have recognized that its application must be held within fair and sensible limitations. "We concluded that the method involves something more than the ordinary use of circumstantial evidence • • •,"—so said the Supreme Court in the *Holland* case, *supra* (P. 124). Moreover, it continued (id. p. 129):

> "While we cannot say that these pitfalls inherent in the net worth method foreclose its use, they do require the exercise of great care and restraint. The complexity of the problem is such that it cannot be met merely by the application of general rules. • • • Trial courts should approach these cases in the full realization that the taxpayer may be ensnared in a system, though difficult for the prosecution to utilize, is equally hard for the defendant to refute. • • • Appellate courts should review the cases, bearing con-

stantly in mind the difficulties that arise when circumstantial evidence as to guilt is the chief weapon of a method that is itself only an approximation.'"[2]

That opinion further states that it is an essential condition in such a case that the Government establish "with reasonable certainty * * * an opening net worth" (p. 132). We have used similar and not less poignant words of warning ourselves with respect to the nature and limits of this method of developing a case against a taxpayer. *Cf. Bryan* v. *United States,* 5 Cir. 1949, 175 F. 2d 223, 227, affirmed 338 U. S. 552; and *Demetree* v. *United States,* 5 Cir., 1953, 207 F. 2d 892.

Also, in *Holland* v. *United States, supra,* (p. 126) the Supreme Court made this significant statement: "One basic assumption in establishing guilt by this method is that most assets derive from a taxable source, and that when this is not true the *taxpayer is in a position to explain the discrepancy*". (Emphasis supplied) This one sentence indicates clearly that the cautious approval given the net worth method is based primarily upon the assumption that a living taxpayer, with his intimate knowledge of all the facts, can and will destroy a man of straw constructed by the Commissioner. It follows that the device has no place in the Government's dealings with the estates of its citizens after they are dead and unable to protect themselves. Doubtless if this decedent had been alive and able, by his oral testimony, to apply the key to the code[3]

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[2] The Supreme Court said in that case also (pp. 126-7): "The net worth method, it seems, has evolved from the final volley to the first shot in the Government's battle for revenue, and its use in the ordinary income-bracket cases greatly increases the chance for errors." In this case it constituted all the shots in between, also.

[3] The use of the code dated back to 1906, long before the first income tax law.

and supplement the set of books which was manifestly sufficient for his own needs, this injustice would have been averted.

It is fundamental in the Anglo-Saxon scheme of justice, recognized at common law and by statutes in practically all the states, that those who are not able to speak for themselves shall be accorded protection by the sealing of the lips of their adversaries as to transactions between them. We ought to apply such a principle of rudimentary justice here. We ought to avoid giving color to the thesis that the exigencies of the exchequer are such that those employed to keep it replenished may deal with taxpayers in any spirit not dominated by absolute fairness, tinctured even by a touch of chivalry and magnanimity.

For these reasons, I would reverse the decision of the Tax Court.

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In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 921

W. FRANK LEE, JR., AS ADMINISTRATOR OF THE ESTATES OF W. FRANK LEE, DECEASED, AND ANNE H. LEE, SURVIVING WIFE, NOW DECEASED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 350–365) are not officially reported. The opinion of the Court of Appeals (R. 394–406) is reported at 227 F. 2d 181.

JURISDICTION

The judgment of the Court of Appeals was entered on November 25, 1955 (R. 407). A petition for rehearing (R. 416–422) was denied on

the total approximate amount of $11,000. (R. 353.)

During the years 1938, 1939, 1940, and 1941, taxpayer obtained a number of small loans from the Washington Loan & Banking Company, Washington, Georgia. These unsecured loans ranged in size from a minimum of $300 to a maximum of $1,500. From 1934 until his death, the only bank account which taxpayer maintained was at the Washington Loan & Banking Company, except for one opened for him by Lee, Jr., in the Farmers and Merchants Bank on the day before his death. (R. 353.)

The Collector of Internal Revenue for the District of Georgia has no record of income tax returns having been filed by taxpayer during the years 1930 to 1939, inclusive. He filed a return for the fiscal year ending February 28, 1941, disclosing net income of $3,115.77, and paid a tax thereon of $35.89. Taxpayer's only substantial source of income reported on his tax returns during the taxable years in question was from the W. Frank Lee Department Store. He also reported stock dividends totaling approximately $17,000 for the taxable years ending February 29, 1944, to February 28, 1950. (R. 354.)

Single entry books of account were maintained for taxpayer's retail clothing business, but few books or records of his other financial transactions were kept. Sales and expenses were re-

corded on the business books as daily totals, and few original supporting records were retained. Cash sales and credit sales were segregated as were collections on accounts receivable, but no breakdown of expense items was recorded. There was no cash account on the books, and taxpayer kept no other records of the amount of cash that he had on hand at any time. Until June, 1947, almost all entries on the business books were made by taxpayer. Thereafter, the entries were made principally by Lee, Jr., and only upon occasion by taxpayer. (R. 358.)

Taxpayer took a physical inventory of merchandise on hand in the store every year and kept inventory records. Taxpayer paid some of the store expenses by check and some by cash. Invoices for merchandise purchased and rent were usually paid by check; and wages, except year-end bonuses, were normally paid in cash. Taxpayer had an average of two employees in the store, and from time to time hired additional temporary help. The regular employees received a weekly salary plus an annual bonus based upon their total sales for the years. (R. 359.)

During the taxable years in question, taxpayer acquired assets, such as United States bonds, stocks, and real estate. The yearly acquisition of such assets was almost always in excess of the amount of income reported for said years, and the total of such assets acquired and owned by the

taxpayer as of February 28, 1949, exceeded by approximately $52,000 the total amount of income reported during the prior eight-year period. The estate tax return also disclosed that the taxpayer's estate had assets considerably in excess of the total amount of income reported by the taxpayer in years subsequent to his bankruptcy adjudication. (R. 354–356.)

Concluding that the taxpayer had not maintained books and records which adequately and correctly reflected his taxable income, the Commissioner used the net worth method in determining the taxpayer's corrected net income for the years in question. To the increase in total net worth over each previous year, the Commissioner added net federal income taxes paid and an amount representing nondeductible living expenses to arrive at taxpayer's net taxable income for the years in question. Appropriate adjustments were also made for capital gains and losses. (R. 355–356.)

Taxable net income as reported on taxpayer's returns for the fiscal years here in question, the taxpayer's net worth at the end of each year, and taxable net income as determined by the Commissioner in deficiency notices are as follows (R. 354–355):

Fiscal year	Taxable net income as reported by decedent	Net worth	Taxable net income as determined by respondent
February 28, 1941		$21,754.92	
February 28, 1942	$45,126.58	30,003.83	$10,784.80
February 28, 1943	7,217.09	45,039.80	16,780.37
February 29, 1944	10,026.19	65,651.44	25,203.92
February 28, 1945	14,769.70	98,649.78	37,987.97
February 28, 1946	11,774.50	116,558.37	27,167.10
February 28, 1947	10,871.97	138,345.46	25,109.12
February 29, 1948	9,685.88	158,007.75	25,567.16
February 28, 1949	10,135.96	173,340.12	21,681.86
February 28, 1950	9,419.27	183,258.06	15,776.35
Total	89,027.14		206,058.65

The Tax Court, on all the evidence, sustained the tax deficiencies determined by the Commissioner, including the addition to tax for fraud for the taxable years 1942 through 1949, and the addition to tax for delinquent filing in 1947. (R. 360–365.) The Court of Appeals, Judge Cameron dissenting, affirmed the Tax Court's decision. (R. 394–406.)

ARGUMENT

1. To the extent that the petition raises issues whether the taxpayer had income in excess of that reported on his returns and whether the Commissioner sustained his burden of proving fraud (questions numbered 2, 3 and 7, Pet. 2–3), the questions are purely factual in nature. The Tax Court gave full consideration to these factual matters (R. 360–365), and the Court of Appeals, on its consideration of the evidence, concluded that the Commissioner had sustained his burden of proof and that the findings of the Tax Court were well founded (R. 398–399).

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Since both of the lower courts are in agreement on the fundamental facts that the taxpayer had failed to report his income properly, that he had done so with "fraud with intent to evade tax," and that the Commissioner had correctly ascertained the correct amount of his taxable income, these factual questions, absent an exceptional showing of error, will not be the subject of further review by this Court. See *Comstock* v. *Group of Investors,* 335 U. S. 211, 214; *Corn Products Co.* v. *Commissioner,* 350 U. S. 46, 51.

The record affords ample justification for the concurrent factual conclusions of the courts below. The evidence shows that taxpayer had no opportunity, subsequent to his adjudication as an involuntary bankrupt in 1930, to accumulate any assets in addition to those used by the Government in establishing his opening (1941) net worth. At the time of his adjudication in bankruptcy, his debts to secured creditors ($11,549) exceeded the value of his assets ($9,418), unsecured creditors agreeing to accept payment for their debts ($19,889.30) at the rate of 15 cents on the dollar. (R. 341, 353; Ex. K.) From 1930 to 1939, taxpayer filed no income tax returns either with the Federal Government or with the State of Georgia. (R. 108, 340–341, 354.) On the federal income tax return filed for the fiscal year 1941, he did not disclose any substantial amounts of income. ($3,115.77, R. 354.) Prior to Febru-

ary 28, 1941, the only bank account he maintained reflects negligible balances. (Ex. EE; R. 136, 142.) Furthermore, taxpayer, during that period, was constantly negotiating small loans ranging from $300 to $1,500 with which to finance his business. (R. 131, 135–136; Ex. DD.)

Exhibit II (R. 179, 348, 355–356) gives the details of the Government's net worth computation, most of the items therein being taken from the stipulation of facts. Revenue Agent Denning testified that he made an exhaustive investigation of all available sources to ascertain taxpayer's assets and liabilities on the focal date of March 1, 1941, the beginning of the first taxable year. (R. 176, 177–203.) His testimony was corroborated by the fact that the taxpayer listed no other assets on schedules for taxes in Wilkes County. (Ex. JJ; R. 190–191.) During the hearing, no effort was made by petitioners to prove that there were any assets on that date that had been overlooked. There is no basis in the record for any inference that taxpayer had any undeposited cash or other concealed assets on February 28, 1941.

Furthermore, the Tax Court concluded (R. 360–361) and the Court of Appeals agreed that the taxpayer's books and records and his tax returns did not adequately and clearly reflect his income. The taxpayer kept single entry books for his clothing business, but he kept no record of his other business activities, and no records of

cash funds or other assets (R. 165, 168, 171, 240; Ex. HH.) The books kept showed no details of either income or expenses, and there were no substantiating cash register tapes, sales slips, invoices or receipts to support any entries in the books. (R. 166–168, 171, 175, 249; Ex. HH.) Entries taxpayer had made in code on the books were not decipherable. (R. 169–170, 209–210.) There is no cash account in taxpayer's clothing store books by means of which the income reflected thereby can be verified or checked. (R. 168, 358.) Even for the period after 1947, when taxpayer's son kept the books, there was no testimony that the books were accurately kept.

Under the circumstances, the factual conclusion that the taxpayer had income during the taxable years (1941–1950) commensurate with growth of his visible wealth seems inescapable. During this period, his total reported income was $90,000, while, during the same period, he acquired assets of over $142,000 and had annual living expenses of from $2,000 to $3,000. Also, the fact that the taxpayer, an experienced business man, had consistently failed to report his true income (the understatement of income being more than 100 percent of the reported income in every year but one) and had failed to keep accurate books and records of all his business transactions, was ample justification for the finding that the understatements were fraudulent with an intent to evade the tax.

These factual questions, which were resolved against the taxpayer by both courts below, do not present issues which form a basis for the granting of the petition.

2. The questions of law which petitioners seek to raise are insubstantial.

(a) It is contended (Question 1, Pet. 2, 9–12) that the courts below were wrong in permitting the Commissioner to compute the amount of the taxpayer's unreported income and to determine the amount of the tax deficiencies by reference to the increases in the taxpayer's net worth during the taxable years in controversy. The argument (Pet. 9) is that a "net worth income reconstruction should not be used against a deceased taxpayer" since he is not available to explain the difference between visible increases in his assets and the lesser amount of income which he reported in his tax returns.

The taxpayer, however, can scarcely be contending that there is some rule of law which forbids one method of proof, while permitting others, where the question concerns the amount of income which a deceased taxpayer failed to report during his lifetime. The fact that the deceased taxpayer is not available to explain his transactions is, of course, an element to be taken into account by the triers of fact. But in the present case, where the financial history of the taxpayer was clear, where his books and records

were inadequate, where there was no dispute concerning the discrepancy which existed between his income, as reported, and the much greater income out of which his growth in wealth must have come, and where there was no attempted explanation which could possibly account for the discrepancy, there was a firm basis for determining and sustaining the tax deficiencies.[2]

Furthermore, whenever the taxpayer is dead, it could always be contended that a deficiency determination, even though based on other kinds of proof, might have been disproved if the taxpayer had been able to give his personal explanation. In short, the logical application of taxpayer's position would be that a deficiency can never be asserted after a taxpayer is deceased. Needless

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[2] It will be noted that the net worth method has been used in various cases where the taxpayer was deceased. See *Scadron's Estate* v. *Commissioner*, 212 F. 2d 188 (C. A. 2d), affirming *per curiam* Tax Court memorandum decision of April 17, 1953 (1953 P-H T. C. Memorandum Decisions, par. 53,133); *Estate of Briden* v. *Commissioner*, 11 T. C. 1095, affirmed, *sub nom. Kirk* v. *Commissioner*, 179 F. 2d 619 (C. A. 1st); *Estate of Reimer* v. *Commissioner*, 12 T. C. 913, affirmed, *per curiam*, 180 F. 2d 159 (C. A. 6th); *Hague Estate* v. *Commissioner*, 132 F. 2d 775 (C. A. 2d), certiorari denied, 318 U. S. 787; *Estate of Roth* v. *Commissioner*, decided June 30, 1952 (1952 P-H T. C. Memorandum Decisions, par. 52,215); *Estate of Nweeya* v. *Commissioner*, decided June 29, 1951 (1951 P-H T. C. Memorandum Decisions, par. 51,208); *Estate of Gaviati* v. *Commissioner*, decided February 13, 1941 (1941 P-H B. T. A. Memorandum Decisions, par. 41,108), appeal dismissed, 127 F. 2d 861 (C. A. 9th).

to say, there is not the slightest support in the statute for such a proposition or for the narrower aspect of it which is urged in the petition.

Both courts below were fully mindful of the legal principles to be applied where a net worth analysis is involved and the opinions disclose a correct application of the theory.

(b) It is also contended (Questions 5 and 6, Pet. 3, 16–19) that the statutory additions based on fraud (Code Section 293 (b), Appendix, *infra*, p. 18) and for delinquent filing of returns (Code Section 291 (a), Appendix, *infra*, p. 18) abate with a taxpayer's death.

The courts below, in rejecting this contention, have followed the unanimous decisions of three other Circuits and of the Tax Court. See *Scadron's Estate* v. *Commissioner*, 212 F. 2d 188 (C. A. 2d), affirming, *per curiam*, Tax Court memorandum decision of April 17, 1953 (1953 P-H T. C. Memorandum Decisions, par. 53,133); *Estate of Reimer* v. *Commissioner*, 12 T. C. 913, affirmed, *per curiam*, 180 F. 2d 159 (C. A. 6th); *Estate of Briden* v. *Commissioner*, 11 T. C. 1095, affirmed, *sub nom. Kirk* v. *Commissioner*, 179 F. 2d 619 (C. A. 1st). These decisions are in harmony with this Court's decision in *Helvering* v. *Mitchell*, 303 U. S. 391, which characterized the addition to tax for fraud as not punitive, but *remedial* and *compensatory* to the Government,

i. e., to compensate it for loss and expense occasioned by frauds perpetrated on the revenue.

And if, as the unanimous decisions hold, the 50 percent addition for fraud was not intended by Congress to abate with a taxpayer's death, it must also be concluded that the five percent addition for delinquent returns was similarly not intended to abate with death.

(c) Finally, it is contended (Question 4, Pet. 2, 16) that the deficiencies were barred by limitations. But, as taxpayer recognizes, Code Section 276 (a) (Appendix, *infra*, p. 17) provides that the tax may be collected at any time if a false or fradulent return has been filed with intent to evade the tax. Here, the filing of fraudulent returns was established. And it is immaterial that taxpayer died prior to the issuance of the notice of deficiency. *National City Bank of New York* v. *Helvering*, 98 F. 2d 93 (C. A. 2d), affirming 35 B. T. A. 975; *Estate of Jill* v. *Commissioner*, 49 F. 2d 1079 (C. A. 2d), affirming, *per curiam*, *National City Bank of New York, Executor* v. *Commissioner*, 21 B. T. A. 1080.

CONCLUSION

The points raised by the petition are largely factual. They have been determined adversely to the petitioner by the Tax Court and the Court of Appeals. There is no conflict of decisions. No question of general importance is presented

and no further review by this Court is warranted. The petition for a writ of certiorari should be denied.

Respectfully submitted.

SIMON E. SOBELOFF,
Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
HILBERT P. ZARKY,
CAROLYN R. JUST,
Attorneys.

MAY, 1956.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

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(26 U. S. C. 1952 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

* * * * *

(26 U. S. C. 1952 ed., Sec. 54.)

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * *

(26 U. S. C. 1952 ed., Sec. 275.)

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * * *

(26 U. S. C. 1952 ed., Sec. 276.)

SEC. 291. [As amended by Sec. 172 (f) (4) of the Revenue Act of 1942, c. 619, 56 Stat. 798]. FAILURE TO FILE RETURN.

(a) In case of any failure to make and file return required by this chapter, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the tax: 5 per centum if the failure is for not more than thirty days with an additional 5 per centum for each additional thirty days or fraction thereof during which such failure continues, not exceeding 25 per centum in the aggregate. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3612 (d) (1).

* * * * *

(26 U. S. C. 1952 ed., Sec. 291.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

* * * * *

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612 (d) (2).

(26 U. S. C. 1952 ed., Sec. 293.)

SEC. 1112. BURDEN OF PROOF IN FRAUD CASES.

In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Commissioner.

(26 U. S. C. 1952 ed., Sec. 1112.)

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